**U.S.-based multinationals do not avoid taxes,
UNC Kenan-Flagler research finds**

Both President Barack Obama and Sen. John McCain got some of their facts on taxes wrong during the presidential campaign.

President Obama argued that multinationals operating in the United States manage to evade a big chunk of corporate income taxes, while Sen. McCain claimed that this country's high tax rates put it at a competitive disadvantage when compared with other nations.

In reality, U.S.-based multinationals pay neither unusually high taxes nor do they manage, to any great extent, to avoid them, according to a study by Doug Shackelford, Kenan-Flagler's Meade H. Willis professor of taxation, and Kevin Markle, a Kenan-Flagler graduate student in accounting.

Shackelford and Markle's analysis of the financial statements of companies around the world reveals that multinationals operating in the United States paid an effective tax rate of 27 percent in 2006, after controlling for each firm's size and industry. That rate puts the U.S. rate below that of Japan, tied with Germany and quite close to Great Britain and France but well above developing countries like China and India.

"There are extreme views in the political debate in the U.S.—either that nobody would want to do business here because the taxes are too high or that multinationals don't any taxes," Shackelford says. "Our takeaway is that neither is right. The U.S. is in the middle, a little above average."

To reach their conclusion, Shackelford and Markle examined financial statements for more than 10,000 companies in 85 countries over two decades. Shackelford believes that theirs is the largest study of this sort ever undertaken. (For a copy of the paper, please see…link here.)

The two scholars do document a modest amount of tax avoidance in the United States. Lately, the U.S. statutory tax rate for corporate income has been 35 percent. Thus their finding that companies operating here paid an average of 27 percent in 2006 suggests that companies are taking steps to cut their payments to the government.

Digging deeper, Shackelford and Markle conclude that at least some of the cross-country difference in effective tax rate can be traced to the creation of subsidiaries in tax havens like Bermuda. Specifically, they find that having a subsidiary in a tax haven lowers the effective tax rate of a U.S. multinational by 1.6 percentage points.

Though that may seem like a small amount, Shackelford expects that it will draw the attention of policymakers and the media. After all, tax havens—and the companies that choose to use them—generate controversy. While a senator,

President Obama co-sponsored a bill aimed at discouraging U.S. citizens and companies from operating in foreign tax havens. Members of the U.S. Senate and House recently introduced new versions of the bill. The European Union is also taking steps to stamp out the use of tax havens.

The debate has even ensnared the rock band U2 and its lead singer Bono. In 2006, the band moved its business office to the Netherlands, from the band members' native country of Ireland, to take advantage of lower Dutch taxes. Some people in Ireland chided the band for hypocrisy, pointing out that Bono, one of rock's most politically active stars, lobbies for greater aid and services for the poor while, in effect, evading taxes that might contribute to that aid. U2's members have defended the move as simply shrewd business and argued that they still pay millions a year in taxes in Ireland and elsewhere.

From a tax-planning point of view, Shackelford understands why firms, whether musical or manufacturing, seek out havens. "Except for the political controversy, setting up business in Bermuda and other tax-haven countries is easy and saves taxes," he explains. "Incorporating there is little more than a lawyer having a file drawer."

Some of the activities that get lumped with tax avoidance are really just legitimate efforts to diversify risk and create new streams of revenue. "If a North Carolina company gets a contract to pave roads in China," Shackelford notes. "they will set up a plant in China. You could look at that and say, 'There go jobs and tax revenues out of the U.S.' But you're not going to produce asphalt for China in North Carolina. On the other hand, for some businesses it is difficult to identify the location where profits are earned. For example, where are the profits earned for an international phone call—where the call is placed, answered and routed through? In those types of businesses, if we're going to have a tax rate that's above other countries, then we have to accept that companies will arrange their affairs to try to report their profits in more tax-friendly places."

Besides calculating average effective tax rates around the world, Shackelford and Markle's study documents a worldwide drop in rates over the last two decades. They find that rates fell roughly equally across the globe. Thus for the most part, no nation ended up gaining a competitive advantage. Countries that had higher rates in 1988 also had them in 2006. And tax havens—besides Bermuda, such places as the Bahamas, the Cayman Islands and Luxembourg—likewise had the lowest rates then and now.

"Over the last two decades, both statutory and effective tax rates have been going down," Shackelford says. "I don't know why that happened, and people in policy positions don't seem to know, either. But it's been a dramatic falloff."

One possibility is that tax reform in the '80s in the United Kingdom and the United States kicked off a worldwide vogue. Back then, both countries cut their

rates while broadening their tax base—that is, they closed loopholes and made more kinds of income subject to tax. “That seemed to start a domino effect where one country after another broadened the base and lowered rates,” he says. “And if everybody cuts by 20 percent, you end up with roughly the same ranking.”

Thus Japan had the world’s highest tax rate in the ’80s, when it reached 50 percent for multinationals, and it had the highest in 2006, at 36 percent. “Japan is an unusual culture,” Shackelford says. “Paying high taxes there seems to be viewed as a patriotic act, whereas, in most of the rest of the world, it’s viewed as something you do to stay out of jail.”

One country that stands out for slashing its rates is Germany, where the average effective rate for multinationals fell from 47 percent in 1989 to 27 percent in 2006. Shackelford chalks that up to social and economic changes that eroded the country’s status as one of the world’s best places to do business. Between World War II and the early 1970s, Germany boomed. Its workers were famously productive, and its companies reported high profits. Firms were hungry to operate there and willing to pay up for the privilege.

“Eventually, costs increased both to support a highly developed social welfare system and to unify East and West Germany,” he says. “Now it’s no longer an unusually profitable place. It has become just another player in the world market.” Without its special highly profitable status, business weren’t going to stay, if they had to pay higher taxes than in other countries in the developed world.

Shackelford doesn’t see his and Markle’s study as suggesting particular steps that policymakers, either in the United States or abroad, should take. Rather, he hopes that it will bring a measure of reasonableness and objectivity to the often heated and rhetorical debates over tax policy.

“This would be a sexier paper if we’d said, ‘Look at the pillaging by multinationals,’” he adds. “And managers might have thought it was sexier if we’d said that U.S. companies can’t survive because of high taxes. In some sense, the interesting thing is that we’re in the middle.”